IN THE

Supreme Court of the United States

October Term, 1977

Nos. 77-1279
77-1314

MALCOLM K. FLESCHNER, WILLIAM J. BECKER, HAROLD B. EHRLICH, FLESCHNER BECKER, ASSOCIATES, and HARRY GOODKIN & COMPANY,

Petitioners,

v.

ROBERT ABRAHAMSON and MARJORIE ABRAHAMSON,

Respondents.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENTS IN OPPOSITION

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Opinions Below

The opinion of the District Court (Pet. App. 54-74)* is reported at 392 F. Supp. 740.

An interim opinion of the Court of Appeals (Pet. App. 75-78), reserving decision pending filing of supplemental briefs by the parties and an amicus curiae brief by the SEC, is reported at 537 F.2d 27.

* Throughout this brief the Petition and Appendices attached thereto of petitioners Fleschner, Becker, Fleschner Becker Associates and Ehrlich are referred to as "Pet. —" and "Pet. App. —", respectively. The separately filed Petition of Harry Goodkin & Co. is referred to as "Goodkin Pet. —".

The principal opinion of the Court of Appeals (Pet. App. 3-49) has not yet been officially reported; it is unofficially reported at CCH Fed. Sec. L. Rep. (1976-1977) Transfer Binder ¶ 95,889. This opinion was modified by an order of the Court of Appeals (Pet. App. 50-52), which also has not yet been officially reported.

Jurisdiction

The jurisdictional requisites are adequately set forth in the Petition at p. 2 and in the Goodkin Petition at p. 2.

Question Presented

Did the Court of Appeals correctly hold that respondents are entitled to a trial upon their complaint for damages under the Investment Advisers Act of 1940, naming the managing partners of an investment partnership as defendants as well as the accountant for the partnership, where the Act's legislative history and remedial purposes, and the history of decisional authority finding private rights of action under the federal securities laws, plainly support such a private right of action against an investment adviser and those who aid and abet him; where damages from the investment client's actual reliance on the intentional and material misrepresentations of the advisers and accountant are alleged; and where it is alleged that the accountant acted in concert with the advisers, having actual knowledge of the advisers' fraud?

Statutes

The pertinent provisions of the Investment Advisers Act of 1940, Section 206 (54 Stat. 852, as amended, 74 Stat. 887, 15 U.S.C. § 80b-6) and Section 214 (54 Stat. 856, 15 U.S.C. § 80b-14) are set forth in Petitioners' Appendix at pages 1-2.

Statement of the Case

In their complaint respondents alleged violations of Section 206 of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-6 ("Advisers Act"), and of Rule 10b-5 under the Securities Exchange Act of 1934 ("1934 Act"), arising out of their investment in limited partnership interests in an investment partnership. The principal impropriety alleged was that petitioners had concealed the fact that the partnership had made very substantial investments in unregistered securities. The Court below found that between September 1968 and September 1969, the "firm's investments in unregistered securities fluctuated from about 72% to 88% of its portfolio," although the reports to limited partners continued "not to disclose" these facts (Pet. App. 9).

The District Court, deciding motions by both sides for summary judgment, dismissed the complaint on the ground that respondents suffered no damages (Pet. App. 65-74).

On appeal, the Court of Appeals affirmed as to dismissal of respondents' claim under Rule 10b-5, but reversed, Gurfein, J., dissenting, the dismissal of the Advisers Act claim and remanded for trial. The only claim before this Court is the claim under the Advisers Act.

In reversing, the Court of Appeals held only that there is an implied private right of action under Section 206 of the Advisers Act and that respondents had alleged a claim for damages compensable thereunder (Pet. App. 14-32). The Court carefully withheld any comment as to whether respondents sustained any damages and, if so, how much, but did provide guidance on the proper measure of damages to be employed by the District Court upon remand (Pet. App. 32-33).

The Court below first considered the threshold question of whether any of the general partners of the investment partnership are "investment advisers" within the meaning of Section 202(a)(11) (Pet. App. 14). The Court of Appeals first found that they received compensation for their investment services, and then held, on two independent grounds, that they were "engage[d] in the business of advising others" with respect to investments (Pet. App. 15-18).

Having determined that the general partners of the investment partnership are investment advisers, the Court of Appeals then considered the question of whether a private right of action is to be implied under Section 206 of the Advisers Act. The Second Circuit noted that private rights of action are properly implied in favor of the intended beneficiaries of a statute where necessary to implement the statute's underlying purposes (Pet. App. 20). The Court further observed:

> "There are compelling reasons why the courts have been particularly willing to recognize private rights of action under the antifraud provisions of the federal securities laws. Those provisions are designed to protect specific classes of injured parties. Moreover, the SEC—the agency charged with administration and enforcement of the federal securities laws—does not have sufficient resources alone to enforce the many provisions of the statutes. Absent judicial recognition of private rights of action, the federal securities laws most assuredly would fail to provide the effective regulation over the securities industry which Congress intended." (Pet. App. 20).

For these reasons, the Court said, an implied right of action has been recognized by the courts of appeals under the Investment Companies Act—the legislative companion to

the Advisers Act—as well as under Sections 10(b) and 14 of the 1934 Act and under the Public Utility Holding Company Act of 1935 (Pet. App. 21).

The Second Circuit then considered the circumstances presented here against the factors suggested by the Supreme Court in *Cort* v. *Ash,* 422 U.S. 66, 78 (1975) (Pet. App. 21-22):

> (i) Is the plaintiff one of the class for whose especial benefit the statute was enacted?
>
> (ii) Is there any indication, explicit or implicit, that the Congress intended either to create such a remedy or deny one?
>
> (iii) Is it consistent with the underlying purposes of the legislative scheme to recognize such a remedy for the plaintiff?
>
> (iv) Is the cause of action one traditionally relegated to state law, so that it would be inappropriate to infer a cause of action based solely on federal law?

The Court of Appeals held:

> "We believe that each of these factors point unmistakably toward recognition of an implied right of action under Section 206 of the Advisers Act. See *Piper* v. *Chris Craft Industries, Inc.,* U.S. , 45 U.S.L.W. 4182, 4192-93 (U.S. Sup. Ct. Feb. 22, 1977)." (Pet. App. 22).

The Second Circuit first determined the class for whose benefit the Advisers Act was enacted.

> "The purpose of the Advisers Act was 'to protect the public and investors against malpractice by persons paid for advising others about securities.' The Act was designed for the 'especial' benefit of persons relying upon their investment advisers for advice.

SEC v. *Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 186-91 (1963)." (Pet. App. 22).

The Court then concluded that it would not be inappropriate to infer a cause of action here based solely on federal law.

> "Congress enacted the Advisers Act, as it had earlier securities legislation, mindful of the need for *federal* regulation of the securities industry." (Pet. App. 22; emphasis in original).

The Court of Appeals could find no indication that Congress considered the question of private actions when it enacted the Advisers Act nor any indication that the SEC did so when it adopted Rule 206(4)-1 (Pet. App. 23). Ultimately, therefore, the question is whether the implication of such a remedy would be consistent with the underlying legislative purposes:

> "As stated above, the courts consistently have recognized that the Commission's resources are inadequate to the task of policing alone the federal securities laws. In enacting the 1940 legislation, Congress intended to provide effective *federal* regulation of an important segment of the securities industry. Failure to recognize a private right of action under the Advisers Act would effectively frustrate that purpose." (Pet. App. 23; emphasis in original).

The Court therefore reached the logical conclusion:

> "The Supreme Court, in considering a different issue under the Advisers Act in *SEC* v. *Capital Gains Research Bureau, Inc., supra,* 375 U.S. at 195, emphasized that the Act should 'be construed like other securities legislation "enacted for the purpose of avoiding frauds," not technically and restrictively, but flexibly to effectuate its remedial purposes.' (footnote omitted). We find that particularly cogent here where we are asked to determine whether there should be a private right of action to recover damages for what may be clear violations of the Act. Moreover, mindful of the Supreme Court's admonition in *J. I. Case* v. *Borak, supra,* 377 U.S. at 433, we believe that we should provide 'such remedies as are necessary to make effective the congressional purpose', rather than adopt a construction that would effectively defeat the purpose of providing federal regulation over an important segment of the securities industry.
>
> "We hold that there is an implied private right of action under Section 206 of the Advisers Act." (Pet. App. 27; footnote omitted).

Finally, the Court of Appeals considered the question of damages. It rejected petitioners' arguments that respondents' damage claims are too speculative as "clearly inconsistent with the intent of Congress" (Pet. App. 30) and found petitioners' reliance on *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975), misplaced. The Court noted in this regard:

> "The *Blue Chip* decision was based on the *express language* of Section 10(b) and Rule 10(b)-5 requiring a fraud 'in connection with the purchase or sale of any security'. *Neither Section 206 of the Advisers Act nor Rule 206(4)-1 contains any such requirement.*" (Pet. App. 29-30; emphasis in original; footnote omitted).

Having found the respondents' alleged damages compensable under the Advisers Act, the Court discussed the proper measure thereof and found:

> "The proper measure of damages then would be that part of net losses incurred on unregistered securities after the point when the defendants' repre-

sentations became fraudulent which stems from the portion of those investments inconsistent with defendants' representations." (Pet. App. 33).

Reasons for Denying the Writ

I

The decision of the Court below is the reasoned and inevitable product of more than forty years' experience with the federal securities laws. Although, as the Court of Appeals noted in its interim opinion of November 21, 1975, no federal appellate court had yet decided whether a private right of action exists under the Advisers Act (Pet. App. 78), implied private rights of action had been found under all of the other major federal securities laws; the Second Circuit was the first appellate court to find an implied private right of action under the Advisers Act only because it was the first to rule on the subject. There is nothing startling about its reasoning. The decision below was entirely consistent with a long line of cases finding implied private remedies under the federal securities laws.*

* The Second Circuit first stated why there have been so many such decisions under the securities laws (Pet. App. 20):

> "There are compelling reasons why the courts have been particularly willing to recognize private rights of action under the antifraud provisions of the federal securities laws. Those provisions are designed to protect specific classes of injured parties. Moreover the SEC—the agency charged with administration and enforcement of the federal securities laws—does not have sufficient resources alone to enforce the many provisions of the statutes. Absent judicial recognition of private rights of action, the federal securities laws most assuredly would fail to provide the effective regulation over the securities industry which Congress intended."

The Court then collected some of the major decisions (Pet. App. 21):

(footnote continued on following page)

Since the decision below, the same issue has been presented to the Fifth Circuit in *Wilson* v. *First Houston Investment Corp.*, 566 F.2d 1235 (5th Cir. 1978).* In its opinion, the Fifth Circuit declined the opportunity to create a conflict between the Circuits and ruled, Hill, J., dissenting, that there is an implied private right of action under the

(footnote continued from preceding page)

> "Applying these principles, the courts of appeals consistently have recognized an implied right of action under the Investment Companies Act—the companion to the Advisers Act. *Moses* v. *Burgin*, 445 F.2d 369 (1 Cir.), *cert. denied*, 404 U.S. 994 (1971); *Herpich* v. *Wallace*, 430 F.2d 792, 815 (5 Cir. 1970); *Esplin* v. *Hirschi*, 402 F.2d 94, 103 (10 Cir. 1968), *cert. denied*, 394 U.S. 928 (1969); *Taussig* v. *Wellington Fund, Inc.*, 313 F.2d 472, 476 (3 Cir.), *cert. denied*, 374 U.S. 806 (1963); *Brown* v. *Bullock*, 194 F.Supp. 207 (S.D. N.Y.), *aff'd*, 294 F.2d 415, 420-21 (2 Cir. 1961) (en banc). It is well settled that implied rights of action exist under Section 10(b) of the 1934 Act and Rule 10b-5, which contain substantially the same language as Section 206 of the Advisers Act. *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 730 (1975); *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, *supra*, 404 U.S. at 13 n.9; *Fischman* v. *Raytheon Mfg. Co.*, 188 F.2d 783, 787 (2 Cir. 1951); *Kardon* v. *National Gypsum Co.*, 69 F.Supp. 512 (E.D. Pa. 1946). Judicially implied rights of action also have been found under Section 14(a) of the 1934 Act, *J.I. Case Co.* v. *Borak*, *supra*, and under the Public Utility Holding Company Act of 1935, *Goldstein* v. *Groesbeck*, 142 F.2d 422 (2 Cir.), *cert. denied*, 323 U.S. 737 (1944)."

* District Court decisions dealing with the question are collected in the Petition (p. 8, n.8). We think it is fair to say that the few cited decisions denying a private remedy are distressingly brief, and contain very little in the way of exposition, reasoning or consideration of authorities. The opposite is true of the decisions recognizing the right of action. We note that one case, *Gammage* v. *Roberts, Scott & Co.* 1974-75 CCH Fed. Sec. L. Rep. Transfer Binder ¶ 94,761 (S.D. Cal., 1974), is incorrectly cited by petitioners. We also note that they have omitted reference to a case in which a private right of action was recognized: *Jones* v. *Equitable Life Assurance Society*, 409 F.Supp. 370 (S.D.N.Y. 1975). Commentators who have reviewed the District Court decisions have agreed that a private right of action should be recognized. See the decision below (Pet. App. 19, n.17).

Advisers Act. In *Wilson,* the Court, citing the decision of the Second Circuit in the case at bar, rejected the very arguments raised by petitioners both below and in the instant petition.

Petitioners now ask this Court to review a decision which is thoroughly logical in its reasoning and its application of principles announced by this Court.* The petition presents no important question of federal law as to which there is any serious doubt, and there is no conflict of decisions among the courts of appeals. Accordingly, there is no reason for further review of this case by this Court.

Petitioners, we believe, have seriously distorted the decision of the Court below and have raised *in terrorem* arguments of no consequence. Each of their points is discussed below.

II

Petitioners' principal argument against an implied private right of action relies on the omission of three words from the jurisdiction and venue provisions of Section 214 of the Advisers Act, 15 U.S.C. § 80b-14. Section 214 provides that the district courts shall have jurisdiction "of all suits in equity to enjoin any violation of this subchapter." The language of Section 214 is similar to, but not quite the

* The Court below observed (Pet. App. 20),

"The Supreme Court has recognized in a variety of contexts that private rights of action may be implied in favor of the intended beneficiaries of a statute where necessary to implement the statute's underlying purposes. *Superintendent of Insurance* v. *Bankers Life & Casualty Co.,* 404 U.S. 6, 13 n.9 (1971); *J.I. Case Co.* v. *Borak,* 377 U.S. 426 (1964); *Tunstall* v. *Brotherhood of Locomotive Firemen and Enginemen,* 323 U.S. 210 (1944); *Texas & Pacific R.R.* v. *Rigsby,* 241 U.S. 33 (1916). Cf. *Bivens* v. *Six Unknown Narcotics Agents,* 403 U.S. 388 (1971); *Bell* v. *Hood,* 327 U.S. 678 (1946)."

same as, the language of the jurisdictional sections of other federal securities laws. The jurisdictional provisions of the Securities Act of 1933 (15 U.S.C. § 77v), the Securities Exchange Act of 1934 (15 U.S.C. § 78aa), the Public Utility Holding Company Act of 1935 (15 U.S.C. § 79y), and the Investment Company Act of 1940 (15 U.S.C. § 80a-43) all refer not only to suits in equity, but also to "actions at law brought to enforce any liability or duty" created by these statutes. Petitioners' argument is that the omission of the words "actions at law" limits the jurisdiction of the federal courts under § 206 to criminal prosecutions and SEC enforcement proceedings.

However, ordinary statutory construction supports respondents' position herein. The other securities laws referred to above contain provisions which *expressly* create private rights of action under certain sections, although not under others. For example, private rights of action are expressly created under Sections 11 and 12 of the Securities Act; under Sections 9(e), 16(b) and 18 of the Securities Exchange Act; under Sections 16(a) and 17(b) of the Public Utility Holding Company Act; and under Section 30(f) of the Investment Company Act. Because those statutes expressly create private rights of action, the inclusion in their jurisdictional sections of references to "actions at law" is entirely understandable.

The Advisers Act, however, created no *express* rights of action. For this reason a reference to such actions was unnecessary and its omission is entirely consistent with careful draftsmanship. This is precisely the interpretation adopted by the Second Circuit below:

> "In our view, the reason for this omission is that each of the other Acts whose jurisdictional provisions refer to 'actions at law' contains one or more sections *expressly* granting injured parties a private

right of action for damages. There is no provision in the Advisers Act which *expressly* provides for private actions; since it is a less complex statute, containing no express grants of right of action to private parties, a reference to 'actions at law' would be superfluous." (Pet. App. 25; emphasis in original).

Accord, *Bolger* v. *Laventhol, Krekstein, Horwath & Horwath,* 381 F.Supp. 260, 264-65 (S.D.N.Y. 1974).

Although petitioners suggest elaborate explanations for the language of Section 214, nothing in the legislative history* supports their position.

* The Investment Advisers Act, in the form in which it was originally introduced, provided that the jurisdictional provision of the Investment Company Act should be "incorporated in this title as though fully set forth therein." S. 3580, Section 203, 76th Cong., 3d Sess. The jurisdictional section of the Investment Company Act had been copied verbatim from the Public Utility Holding Company Act. S. 3580, Section 40(a), 76th Cong., 3d Sess. The companion bill introduced in the House of Representatives at the same time contained identical jurisdictional provisions. H. R. 8935, Sections 49(a), 203, 76th Cong., 3d Sess.

The Senate bill, when it was reported out of committee, had been amended to eliminate the incorporation by reference of the jurisdictional provisions of other statutes. The jurisdictional provision in the Advisers Act was instead spelled out, and contained no reference to actions at law to enforce liabilities created by that Act. But the committee report contains no comment upon the absence of such language, and certainly contains no indication that the deletion of references to actions at law was to prevent the implication of private rights of action.

In fact, the only comment in the Senate committee report dealing with the jurisdictional provisions of the Investment Company Act and the Investment Advisers Act demonstrates that no significant difference between those provisions was intended. The report discussed the provisions dealing with "unlawful representations, administration and enforcement machinery and formal provisions" as a group. In its discussion of such provisions as they appeared in the Advisers Act, the report stated that the Advisers Act "contains provisions generally comparable to those of" the Investment Company Act. S. Rep. 1775, 76th Cong., 3d Sess., p. 23.

(footnote continued on following page)

The Second Circuit, considering in the opinion below the same suggested explanations in even greater detail, concluded:

> "There is not a shred of evidence in the legislative history of the Advisers Act to support the assertion that Congress intentionally omitted the reference to 'actions at law' in order to preclude private actions by investors. Section 214, like the jurisdictional provisions of the other securities acts, was drawn to provide jurisdiction over actions expressly authorized by the statute. Far from indicating that Congress ever considered the matter of private actions in drafting Section 214, the only legislative history indicates that Congress attached no great importance to its omission. In their only references to Section 214, both the Senate and House Reports stated that the enforcement provisions of the Advisers Act were 'generally comparable' to those of the Investment Companies Act, whose jurisdictional provision contains the 'actions at law' language. S. Rep. No. 1775, 76th Cong., 3d Sess., at 23 (1940); H.R. Rep. No. 2639, 76th Cong., 3d Sess., at 30 (1940)." (Pet. App. 25-26).

(footnote continued from preceding page)

The House Committee on Interstate and Foreign Commerce reported out a bill identical to the Senate bill. H.R. 10065, 76th Cong., 3d Sess. The House Committee report also states that the sections of the Advisers Act dealing with "unlawful representations, administrative and enforcement machinery" contain "provisions comparable to those in" the Investment Company Act. H. Rep. No. 2639, 76th Cong., 3d Sess., p. 30.

These references in the legislative history hardly qualify as evidence that the Congress intended to prohibit private rights of action under the Advisers Act. Not only is there no language in the committee reports which even hints at such an intention; the jurisdictional provision of the Investment Company Act, to which the jurisdictional provision of the Advisers Act was intended to be "comparable", has been held to support a private right of action. See *Brown* v. *Bullock,* 194 F.Supp. 207 (S.D.N.Y.), *aff'd en banc,* 294 F.2d 415 (2d Cir. 1961).

Petitioners disagree with this analysis, which they themselves quote. However, it cannot be argued, as petitioners do, that the absence of expressly created private rights (and a jurisdictional section referring to actions at law to enforce them) indicates a Congressional intent to withhold private rights from those for whose benefit the statute was passed. That argument would lead to the illogical conclusion that no *implied* rights exist unless *express* rights are first granted. The law is otherwise. The doctrine of implied private rights of action arose precisely *because* statutes obviously designed to protect certain classes of persons omitted to provide those persons with express private remedies. See, e.g., *Texas & Pacific R.R. Co.* v. *Rigsby,* 241 U.S. 33 (1916).

Petitioners argue that the absence of provisions for express private remedies is itself an indication that the Congress intended to prohibit all private remedies. They argue that this conclusion flows from the fact that the Advisers Act was designed merely to effect a "compulsory census" of investment advisers (Pet. 11).

It is certainly true that the Advisers Act is a less complex, less pervasive regulatory enactment than the Exchange Act, for example. This, we think, accounts for the absence of expressly created private rights of action. That the legislation is simply less ambitious than other statutes, however, is no evidence at all that the Congress intended to prohibit private remedies for violations of the provisions it *did* enact, which have harmed those persons it *did* intend to protect. We know of no doctrine that private remedies may be implied only under the most pervasive regulatory schemes.*

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* Indeed, the doctrine of implied remedies would seem more likely to be needed in connection with a less detailed statute.

In any event, the Act is more than a mere "compulsory census." This Court has held that "'avoiding frauds'" was one of its main purposes, *S.E.C.* v. *Capital Gains Research Bureau,* 375 U.S. 180, 195 (1963), and that it was one of the statutes having the "fundamental purpose" of requiring "a high standard of business ethics in the securities industry," *id.* at 186.

Finally, in addition to all of the above, Section 214 supports the implication of a private right of action by its very use of the word "violations." Section 214 gives the district courts "jurisdiction of violations of this subchapter . . ." Similar language is found in Section 27 of the Exchange Act, 15 U.S.C. § 78aa. It has been held, in litigation between private parties, that "violations" refers to civil as well as criminal proceedings. See, e.g., *Osborne* v. *Mallory,* 86 F.Supp. 869, 879 (S.D.N.Y. 1049):

> "Section 27 of the Securities Exchange Act of 1934 . . . gives a federal district court jurisdiction over 'violations of this chapter' . . . The word 'violation is not limited to a criminal case; it includes also civil litigation."

See also *Grossman* v. *Young,* 70 F. Supp. 970 (S.D.N.Y. 1947).

III

The decision and opinion below were the result of a considered analysis and application of principles outlined by this Court in its decisions. Contrary to petitioners' assertions, as the Court of Appeals noted, "the present case is plainly different in a significant legal respect from *National R.R. Passenger Corp.* v. *National Ass'n of R.R. Passengers,* 414 U.S. 452 (1974)". (Pet. App. 27, n. 22a at 28-29). In that case, Justice Brennan, concurring, noted,

"[T]he legislative history of the Amtrack Act provide[d] a clear and convincing expression of Congress' intent to preclude anyone except the Attorney General and in certain situations an employee or his duly authorized representative from maintaining an action under the Act against petitioners . . ." 414 U.S. at 465.

Moreover, the Supreme Court found that national transportation policies not pertinent here militated in favor of such a limitation. Here, however, no such history or policies can be found. The "clear and convincing" point to be extracted from the legislative history of the Advisers Act is that there is a total absence of any stated congressional intent to limit private rights of action thereunder. And, the policies behind the Advisers Act support the implication of a private right of an action.

Petitioners' casual treatment of *National R.R. Passenger Corp.* v. *National Ass'n of R.R. Passengers, supra,* is repeated in their consideration of the Court of Appeals' discussion of *Cort* v. *Ash,* 422 U.S. 66 (1975). *Cort* v. *Ash* specifies four factors relevant to the determination "whether a private remedy is implicit in a statute not expressly providing one." 422 U.S. at 78. Petitioners state that the Court of Appeals' decision refers to *Cort* v. *Ash* only "in passing" (Pet. 16), and that it "totally omits any point-by-point discussion of its four criteria, as Judge Gurfein points out in dissent (A39-40)." (Pet. 16-17). The Second Circuit's application of *Cort* v. *Ash* and its four factors has been discussed above (pp. 6-7), and we respectfully invite this Court's attention to that portion of the opinion below (Pet. App. 21-24). It will be seen that the Court below did in fact apply *Cort* v. *Ash* on a "point-by-point" basis. We note here only that Judge Gurfein nowhere points out any "omission" in his dissent; he disagrees with the majority's view of the second factor listed in *Cort,* i.e., legislative intent, but does not fault their "point-by-point discussion."

Similarly, petitioners' selective quotation from *Piper* v. *Chris-Craft Industries, Inc.,* 430 U.S. 1 (1977), hides the essential holding of that case. In *Piper,* Chief Justice Burger, writing for the majority, noted:

"[W]here congressional purposes are likely to be undermined absent private enforcement, private remedies may be implied in favor of the particular class intended to be protected by the statute." 430 U.S. at 25.

The Court then examined the legislative history of the Williams Act of 1968, 15 U.S.C. § 78n(e), and determined that Congress had intended to protect the shareholders of target companies by regulating takeover bidders. Chris-Craft, the defeated tender offeror, was not a member of the class Congress sought to protect. Accordingly, an implied right of action in favor of Chris-Craft was not necessary to effectuate Congress' goals. In the present case, however, as the Second Circuit found below and as the Fifth Circuit found in *Wilson* v. *First Houston Investment Corp., supra,* an implied private right of action *is* necessary to make effective the congressional purposes behind the Advisers Act.*

In reaching this conclusion, both the Court below and the Fifth Circuit in *Wilson* found this Court's pronouncements in *J.I. Case Co.* v. *Borak,* 377 U.S. 426 (1964), to be appli-

* The *Wilson* Court specifically stated, ". . . [T]he reasoning of *Piper* simply does not apply to the instant case where plaintiff is a member of the protected class" (p. 1242). And the Second Circuit in the case at bar cited *Piper* in support of its conclusion that the *Cort* v. *Ash* analysis requires "recognition of an implied right of action under Section 206 of the Advisers Act" (Pet. App. 22).

cable. In *Borak,* this Court, referring to an implied right of action under section 14(a) of the 1934 Act, pointed out that "Private enforcement . . . provides a necessary supplement to Commission action" (p. 432),* and stated (p. 433),

> "[I]t is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose."

The Court below found that the Commission's resources are too limited for it *"alone"* to be expected to provide effective enforcement of the Advisers Act (Pet. App. 20; emphasis added). The Commission itself has expressly taken a similar position. See *SEC Legislative Proposals Concerning Regulation of Investment Advisers,* SRLR No. 332 (BNA, December 17, 1975) pp. E-1 *et seq.,* wherein the Commission stated (p. E-7),

> "[P]rivate litigation would serve as a valuable adjunct to Commission enforcement action." **

There can thus be little doubt that "congressional purposes are likely to be undermined absent private enforcement" of the Advisers Act.

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* It is noteworthy that proxy soliciting material distributed under section 14(a) is actually filed with the SEC before it may be mailed. 17 C.F.R. § 240.14a-6. This is not true of the sort of annual and monthly reports by investment advisers claimed in this case to have contained false and misleading statements. If the SEC lacks the resources to act as sole enforcement agent as to violations contained in material actually filed with it, then the need for private enforcement as to unfiled materials is even greater.

** In this document, as petitioners point out, the SEC suggested adding the words "actions at law" to Section 214. But this was only to put to rest those few District Court decisions holding, on the basis of Section 214, that no private right of action exists. The Commission expressly stated that it believes Section 214, as presently written, supports a private right of action (p. E-7).

IV

Petitioners dispute the finding below that the general partners of an investment partnership are "investment advisers" within the scope of the Advisers Act.*

The Court below found that the general partners were investment advisers on two distinct grounds, both of which are correct, and one of which is not even challenged in the petitions. The discussion of the Court of Appeals may be found at Petitioners' Appendix pages 14-18. Having found that the general partners received compensation for managing the limited partners' investments**—and this is not denied by petitioners—the Court below then turned to the inquiry whether they were "engage[d] in the business of advising others" with respect to these investments:

> "On two independent grounds, we believe they were.
>
> "First, the monthly reports which contained the alleged fraudulent representations were reports which provided investment advice to the limited partners. The general partners' compensation depended in part upon the firm's net profits and capital

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* Section 202(a)(ii) of the Investment Advisers Act, 15 U.S.C. § 80b-2(a)(11)(1970), in relevant part provides:

> " 'Investment adviser' means any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities . . . ."

** Each of the three partnership agreements in effect between 1965 and 1970 provided that the general partners would be paid for their services 20% of the firm's net profits and net capital gains for each fiscal year. In addition, the partnership agreement of October 1, 1968 authorized an annual salary of $25,000 for each general partner who managed investments (Pet. App. 14-15).

gains. These in turn were affected by the size of the total funds under their control. The monthly reports were an integral part of the general partners' business of managing the limited partners' funds. In deciding whether or not to withdraw their funds from the pool, the limited partners necessarily relied heavily on the reports they received from the general partners.

"Secondly, wholly aside from the monthly reports, we believe that the general partners as persons who managed the funds of others for compensation are 'investment advisers' within the meaning of the statute. This is borne out by the plain language of Section 202(a)(11) and its related provisions, by evidence of legislative intent and by the broad remedial purposes of the Act." (Pet. App. 15).

Petitioners conspicuously omit any discussion on this point of the legislative history of the Advisers Act. As noted by the Court below (Pet. App. 16-17), the SEC study which led to the adoption of the Advisers Act referred not only to investment advisers who made recommendations to clients, but also to investment advisers "with management powers over their clients' funds and the power to make purchases and sales for their clients . . . ." (Pet. App. 16). The Court of Appeals also observed (Pet. App. 16-17) that the Report of the Senate Committee on Banking and Currency which accompanied the bill to the Senate floor stated,

"The report of the Commission to the Congress and the record before the committee is clear that the solution of the problems and abuses of investment advisory services—*individuals and companies which either handle pools of liquid funds of the public or give advice with respect to security transactions*—cannot be effected without Federal legislation."

* * *

"Virtually no limitations or restrictions exist with respect to the honesty and integrity of persons who may solicit funds to be *controlled, managed, and supervised.*" (Emphasis added.) S. Rep. No. 1775, 76th Cong., 3d Sess., 21 (1940).

There are, of course, other portions of the legislative history and other provisions in the Advisers Act itself* which lead to the same conclusion and which are discussed in detail in the opinion below (Pet. App. 15-18). We need not refer to them further.

There is also no substance to petitioners' purported fear of runaway extrapolation from these principles. Specifically petitioners claim (Pet. 19):

"Under the rationale of the majority opinion below, not only general partners of investment partnerships but every compensated trustee, executor and other fiduciary with discretionary investment powers would be deemed an investment adviser" (Emphasis in original)

This fear, if real, is simply foolish. Many such trustees are banking institutions or lawyers and are specifically *exempted* from adviser status under the express provisions of Sections 202(a)(11)(A) and (B). Many other persons who are relatives or trusted friends of a decreased person, for example, and are serving as testamentary trustees, obviously cannot be said to be "in the business" of doing so, and hence are also excluded by definition from adviser status by express statutory language.

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* See Section 203(c)(1)(D), 15 U.S.C. § 80b-3(e)(1)(D), which requires an adviser's registration to disclose his "authority . . . with respect to clients' funds and accounts"; and see Section 205, 15 U.S.C. § 80b-5, which regulates advisory contracts under which the adviser will, among other things, "manage any investment or trading account . . ."

Still other trustees whose investment advising role is merely incidental to more significant functions may, if in doubt about their status, obtain relief from the SEC under Section 202(a)(11)(F), pursuant to which the SEC may by rule, regulation, or order add to the list of persons expressly exempted by the Congress ". . . other persons not within the intent of this paragraph." *

Petitioners, in support of their contention in this regard, claim that the holding of the Court of Appeals violates the "rule" that persons managing private and family investments are not in the "business of advising others" and are therefore not "investment advisers" under the Advisers Act. (Pet. 18)

There is no such rule and the authorities cited by petitioners do not support them. Thus, in *In the Matter of Augustus P. Loring, Jr.*, 11 S.E.C. 885, 1941-42 CCH Fed. Sec. L. Rep. Transfer Binder ¶ 75,299 (1942) (cited at Pet. 18n 21), the SEC granted an order of exemption to a "professional trustee" noting that the bulk of his business consisted of acting as a "court fiduciary . . . under the supervision of the courts," that services he performed went well beyond the supervision of investments and that "[a]ny advice given by applicant to others as to securities is solely incidental to his activity as a professional trustee."

The factors which moved the SEC to grant an exclusion in *Loring* have no parallel to the instant case, where the investment partnership's *sole* (not "incidental") attraction to investors was the presumed ability of its general partners to trade securities in a sophisticated and profitable manner.

* The SEC has recently exercised this power, exempting certain employee benefit plan trustees. See 17 C.F.R. § 275.202-1 (1976). It has also, on several occasions, ordered exemptions of specific persons in specific cases.

Significantly petitioners omit any mention of the SEC's recent ruling in *Brewer-Burner & Associates, Inc.*, 1973-74 CCH Fed. Sec. L. Rep. Transfer Binder ¶ 79,719 (1974). In *Brewer-Burner,* the inquiring company proposed to act as a "trustee" under the laws of Panama and intended to solicit American investors to establish with it *inter vivos* trusts which would invest in securities. The SEC advised (p. 83, 925),

> "In our opinion, the Panamanian trust company which is to act as trustee would be an investment adviser within the meaning of Section 202(a)(11) of the Advisers Act . . . Accordingly, registration under the Act would be required."

Interestingly, the SEC also cautioned that the trust company may be subject as well to registration under the Investment Company Act. *Brewer-Burner* is flatly inconsistent with petitioners' argument and plainly contradicts the supposed "rule".

Finally in this regard, we note the frequent use by petitioners of the words "private", "family investments", "investment entities for . . . their families and friends", and the like, to describe the investment vehicle involved here. That vehicle, however, had 35 limited partners by April 1, 1966, and had 66 limited partners by October 1, 1968 at which time it also had assets of approximately $60,000,000 (Pet. App. 7). The stress placed by petitioners on the supposedly "private" and intimate nature of the partnership is ill-advised; in 1968 it was larger than at least 87% of the limited investment partnerships surveyed in the SEC's *Institutional Investor Study Report* (1971) (see volume 2, p. 306). In fact, persons other than the general partners and their families owned nearly half the total capital on October 1, 1966 and on October 1, 1967, persons other than the general partners and their families owned over 60% of

the capital on October 1, 1968. Petitioners make their argument about the "privacy" and intimacy of the partnership without once referring to the *very provision of the Advisers Act that is designed to accommodate such considerations.* Section 203, which prescribes registration of investment advisers, further provides:

> "(b) The provisions of subsection (a) of this section [mandatory registration] shall not apply to
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> * * *
>
> "(3) any investment adviser who during the course of the preceding twelve months has had fewer than fifteen clients and who neither holds himself out generally to the public as an investment adviser nor acts as an investment adviser to any investment company registered under subchapter I of this chapter."

By this paragraph, the Congress eased, to the extent it saw fit, the regulatory burdens on adviser activities such as those allegedly engaged in by the general partners here, activities which affect only a small number of people and do not involve solicitations of the public. The exemption is not from the definition of investment adviser or the antifraud rules of Section 206, but only from the requirement to register.

Thus, the Congress, in Section 203, clearly considered the very question now being raised by petitioners: whether a small number of clients, a "private" enterprise, and a lack of public solicitation should be sufficient to exempt an investment manager from the definition of "investment adviser." While petitioners urge that the Congress did not intend to regulate such persons under the Advisers Act, Section 203 makes it quite clear that the Congress felt only that such persons need not register. Congress clearly felt

that they should certainly be subject, however, to the antifraud provisions, which apply to all advisers, registered or unregistered.

V

Petitioner Harry Goodkin & Company ("Goodkin") has submitted a separate petition urging that the Court of Appeals erred in holding that Goodkin could be liable under the Advisers Act as an aider and abetter of the investment advisers. Goodkin argues that Section 206 applies only to investment advisers and that an accountant acting solely in the practice of his profession cannot be held liable thereunder. In making this argument, however, Goodkin seriously misstates the holding of the Court below.

In the first place, the Court of Appeals *agreed* that an accountant's usual activities are exempted from the scope of the Advisers Act. However, the Court of Appeals also held that an accountant may be held liable if he aids and abets an investment adviser *knowing* that the investment adviser is defrauding a client and *knowing* that his conduct is assisting that fraud:

> "[T]he exemption does not shield the accountant from liability under the antifraud provisions of the Act if the accountant aids and abets an investment adviser with *knowledge* that his conduct is assisting an investment adviser in defrauding a client. . . . In view of the limitation of Section 206 to investment advisers, however, we believe that before Goodkin can be held liable as an aider and abetter, there must be a showing that Goodkin: (a) knew of the investment adviser-client relationship; (b) had knowledge of the fraud; and (c) acted in concert with the investment adviser. Cf. *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976)." (Pet. App. 18n. 16; emphasis in original)

Nowhere does petitioner Goodkin acknowledge the severe restrictions imposed by the Court of Appeals on any attempt to hold an accountant liable under the Advisers Act. And nowhere does petitioner Goodkin acknowledge that the Court of Appeals has in fact found no one liable; it merely articulated a stringent standard by which to judge Goodkin's conduct at a subsequent trial:

> "Whether Goodkin is liable for aiding and abetting the investment advisers is one of the issues to be determined at trial pursuant to our remand." (Pet. App. 18 n.16)

VI

Finally, petitioners challenge the guidance on damages given by the Court of Appeals to the District Court upon remand of the action. Petitioners charge that this formulation "conflicts with the basic rule of damages under the federal securities laws (Pet. 19)", "will permit plaintiffs . . . to isolate securities on which profits are reaped from those on which there are losses (Pet. 20)", and will "assure a flood of claims under the Advisers Act (Pet. 21)."

None of these charges is true. None of them takes into account the fundamental differences between the fiduciary relationship between an invetsment adviser and his client and an arms-length purchase or sale transaction. None of them considers the circumspect care exercised by the Court of Appeals to prevent either windfall profits or "a flood of claims".

At the outset we note that petitioners have abandoned their reliance on *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975), in support of their position on this point. See Pet. App. 29-31. Nevertheless, they continue to insist, without analysis or thoughtful consideration, that

"the basic rule of damages under the federal securities laws" is somehow violated. We assume petitioners are referring to a "basic rule" for damages under Rule 10b-5. But the fact is that Section 206 of the Advisers Act was intended to protect the integrity, not merely of an event such as a purchase or sale,* but of a *relationship.* That relationship, moreover, is a *fiduciary* relationship. *SEC* v. *Capital Gains Research Bureau,* 375 U.S. 180 (1963). It is for this reason, we submit, that Section 206 prohibits *all* fraud practiced by an adviser upon his client, and not merely frauds practiced in connection with the purchase or sale of a security.**

Petitioners' other arguments on this point are equally meritless. The Court below specifically and expressly held that a plaintiff may not recover for his losses but ignore his profits:

> "This is not to say, however, that a plaintiff may recover for losses, but ignore his profits, where both result from a *single* wrong". (Pet. App. 32; emphasis in original)

The measure of damages formulated by the Court of Appeals is as follows:

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* Holding petitioners' reliance on *Blue Chip* "misplaced," the Court below said (Pet. App. 29),

> "The *Blue Chip* decision was based on the *express language* of Section 10(b) and Rule 10b-5 requiring a fraud 'in connection with the purchase or sale of any security.' " (Emphasis in original)

** The damage formula below was not "in derogation of the common law." Cf. *SEC* v. *Capital Gains Research Bureau, supra,* 375 U.S. 180, 192. See, e.g., *First Trust of Lincoln* v. *Carlson,* 131 Neb. 325, 268 N.W. 89 (1936), which makes fiduciaries liable on a similar basis for breaches of duty. See also III *Scott on Trusts* § 205; *Bogert on Trusts* § 862; Restatement, Trusts 2d, §§ 205, 206.

"In determining on remand whether plaintiffs have sustained any damages from the alleged fraudulent investments, the district court should determine, first, at what point defendants' representations became fraudulent due to the increasing proportion of portfolio investments in unregistered securities. The court then should compute the total net losses on all holdings of unregistered securities due to changes in price *after* that date. Finally, the court should determine what proportion of FBA's holdings was inconsistent with representations that the partnership was in a 'most conservative posture' and the other representations made to the limited partners. The proper measure of damages then would be that part of net losses incurred on unregistered securities after the point when the defendants' representations became fraudulent which stems from the portion of those investments inconsistent with defendants' representations." (Pet. App. 32-33; emphasis in original; footnote omitted).

Petitioners' fears that the courts will be subjected to "a flood of claims" are plainly unfounded. As the Second Circuit noted, under Section 206, the plaintiff class is limited to "the investment adviser's own clients."* (Pet.

* It is true that Section 206 also prohibits fraud on a "prospective client." We think this language would support a private right of action for damages only where the prospective client was induced by fraud to become an actual client, and suffered damage as a result. In the case at bar, the plaintiffs became and at all pertinent times were actual clients. The SEC, of course, could seek sanctions against advisers who have solicited "prospective clients" through fraud.

Petitioners also argue that the duty of a fiduciary, under the decision below, is "overbroad." They say that the decision below supports a right of action under Section 206 for "non-disclosure" (Pet. 9 n.9). Petitioners overlook the fact that this Court rejected precisely

(footnote continued on following page)

App. 31). Moreover, the damages claimed cannot be considered speculative. Since the client pays the investment adviser for his services, both client and adviser understand that the client will rely upon the adviser's judgment and advice. As the Court of Appeals found:

"We believe that the limited uncertainties involved in a case such as this are not sufficient to to bar recovery on an otherwise valid claim; and they are adequately offset by requiring proof that the misrepresentations were material and proof of reliance." (Pet. App. 31).

We note in conclusion that the Court of Appeals nowhere held that respondents had in fact suffered any damages at all. Respondents have simply been given an opportunity to prove their claim:

(footnote continued from preceding page)

this argument in *SEC* v. *Capital Gains Research Bureau, supra,* 375 U.S. 180, 197. This Court said that, in all likelihood, the Congress "deemed a specific prescription against non-disclosure surplusage" (p. 199). The Court also said, "Failure to disclose material facts must be deemed fraud or deceit within its [the Advisers Act's] intended meaning . . ." (p. 200).

Finally, petitioners suggest that the decision below would permit recovery for a negligent misrepresentation. They argue that Section 206 and Rule 206(4)-1(a)(5) would permit this. Petitioners thus overlook two important facts: First, the complaint in this case alleges that the misrepresentations were intentional (see Pet. App. 32 n.26). Secondly, the Court below specifically disclaimed any intention of ruling on whether negligent misrepresentation may support an Advisers Act claim. The Court said (Pet. App. 32 n.36),

"It is important to note that there is no issue in this case as to whether an investor may recover for negligent misrepresentations by his investment advisor. . . . Petitioners here have alleged that the defendants' misrepresentations were *intentional*. . . . [T]hey [the general partners] would be liable under Section 206 if they *intentionally* deceived the limited partners . . ." (emphasis in original).

"We of course do not intimate *any* views as to whether plaintiffs in fact have sustained any damage and, if so, *how much.* All we hold is that they are entitled to their day in court and an opportunity to prove, if they can, their claim under the Advisers Act." (Pet. App. 33; emphasis in original).

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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